

Future needs in the European payments market

A recently conducted survey among European banks shows the tremendous changes that lie ahead of the European payments industry. Pan-European focus, consolidation and innovation are the ways forward for payment processors and ACHs, argues **Benjamin Syrbe**, advisor to the board of directors, Equens

Market survey

The world is changing faster and faster. The life cycles of products and services and even companies shorten. The same applies for strategies. What are the products and services of tomorrow? What are the strategies for the future? What are the main drivers for success? The innovation forum Banks & Future investigates such interests and research questions regarding current and future needs of banks and their customers. The objective is to analyse how current strategies of banks fit with future needs and challenges and what the effects will be on the business success. The Banks & Future forum deals with issues such as: how will banks be affected by, and respond to, the influence of regulations and external developments such as the single euro payments area (Sepa), the Markets in Financial Instruments Directive (Mifid) and Basel II.

Several international banks, IT partners and service providers under the scientific guidance of the Fraunhofer Institute set up the forum. It is directed towards all interested banks and companies in the financial sector that care about the development of current and future business models and the exploitation of innovation potentials provided, for example, by new technologies. Each year the innovation forum Banks & Future conducts an extensive survey among banking professionals to gather first hand insight into the current status and future developments within the banking industry. In order to optimise the learning effect of the

survey for the European payments industry, Equens extended the Banks & Future survey with a number of specific questions regarding the European payments market.

Preliminary results

The results of the Banks & Future survey show that banks need to overcome some hurdles. The bank customer of today has become more educated and aware in respect to bank products and their performances. The market transparency has substantially increased during the past decade, leading to a much better informed and thus more critical customer. Within the banking industry this is reflected by fierce price competition on standard products. The pressure on cost is unrelenting and it appears that more and more banks are struggling to cope with the changing market conditions. Managing processes more efficiently, upgrading IT, promoting innovative sales concepts, et cetera are the present necessities to survive; especially in the face of the rising overall complexity within the banking sector, driven by new legal standards and regulations.

Banks encounter additional contrary forces from the expanding sales of financial products through near- and non-banks (such as retailers, telecom operators and Web titans). This is certainly encouraging another emerging trend – the growing mass of cherry picking customers who allocate their assets, loans and insurance policies to various financial service suppliers – not just banks. Furthermore, with

ongoing globalisation it is only natural that more and more international banks seek entrance into national markets. Consequently the quantity and variety of financial products and services keep growing. As a result the pressure to differentiate from other financial service providers is steadily increasing.

Within the European payments industry these challenges are especially evident following the introduction of Sepa. Officially introduced to the European payments industry in January 2008, Sepa to date has by far the biggest impact on banks. Technology, payment formats, margins, business models, market structures – everything is affected at the same time!

Pan-European focus

In order to cope with the challenges lying ahead, it is absolutely necessary that stakeholders within the payments industry broaden their historically mostly national focus to a pan-European focus. The survey results strongly support this notion and show that banks will develop in that direction in the future. Initially most banks will establish reach within Europe by connecting directly or indirectly to EBA Clearing. However, within the near future banks plan to broaden their possibilities to reach counterparties by almost equally using one or more ACHs, bilateral agreements or EBA. Consequently, it's not a big surprise that for the vast majority of banks the reach of payment service providers such as ACHs and third-party processors is of utmost

importance and will determine whether they do business with these providers in the future.

Undoubtedly, we will neither see a purely bilateral or multilateral reachability model, nor a pure hub and spoke model in the payments industry in the future. With banks looking for alternatives to the dependency on a single payment service provider or pan-European automated clearing house (Peach) for their reachability, it is most likely that an intelligent network will be the outcome. Banks may then choose to reach a counterparty through bilateral agreements, through the European ACH Association (Eacha), which recently started bilateral exchange of payments between Equens, Iberpay and Seceti, or through a Peach. All options can come along with or without clearing and/or settlement by a third-party processor.

Moreover, within the cards market it seems that banks enlarge their focus as well, with more than one third of banks planning to become an acquirer for international credit or debit card brands. However, in the cards market the picture is not as clear as it seems, with an equal number of banks also looking into the possibility to become an acquirer for national brands. It seems that initiatives such as Monnet offer a welcome alternative to the MasterCard and Visa duopoly.

Ongoing consolidation

Another clear trend in the payments industry is the ongoing market consolidation. This process was started with the international merger between former German Transaktionsinstitut and former Dutch Interpay (now Equens), and with Voca and Link (now VocaLink) in the UK and SIA and SSB (now SIA-SSB) in Italy joining forces. The recently announced intention of Equens and the Italian processor Seceti to jointly establish Equens Italia will most likely not be the last move in that direction.

Within the cards market first movers were First Data with the acquisition of Germany's GZS, Polish Polcard and Austrian APSS and Atos Worldline with the acquisition of Belgium's Banksys. Norway's BBS and Danish company PBS establishing Nets complete this picture.

Innovations such as contactless cards, mobile payments and prepaid cards are also on the radar of banks

The majority of the banks have already reacted to these market developments by establishing cross-border, back office competence centres for payments and cards. Others are planning to do so, thus being able to either efficiently bundle transaction volumes internally or to outsource all or part of their payments processing. More than half of the banks consider full or partial outsourcing of payments processing in the coming two years. The top three reasons for this strategy are:

- in-house processing is too expensive;
- there is insufficient transaction volume; and
- banks don't consider payments processing to be their core competency.

The market consolidation will certainly help to solve some of these issues by creating processors with large transaction volumes that will be able to save costs and therefore be able to offer competitive transaction prices.

Need for innovations

The third trend in the payments industry is the search for innovations. The previously mentioned trends will help to reduce costs and prices and will lead to more

efficiency and quality of competing processors. However, in the long run that will not be enough and again commoditisation will be seen, unless the payments industry is able to provide innovations that provide benefits for corporates and consumers.

Clearly, most banks see the highest potential for future growth in electronic invoicing and electronic payments. Moreover, the majority of banks want payment service providers to support or deliver these new innovations. In addition, other innovations such as contactless cards, mobile payments, prepaid cards and risk management services are also on the radar of banks already. However, for payment service providers it requires more to stay ahead. They also have to start thinking about new innovations that lie even further in the future such as biometric authentication or expansion of their knowledge to other industries such as health care.

The ideal payment processor

Considering the developments that have previously been outlined, what does the ideal payment processor look like? Certainly, the strategy of such a processor has already been aligned with the market developments for quite some time. A pan-European focus is obviously a prerequisite. The ideal payment processor would actively drive market consolidation – without the intention to be the sole survivor – and strongly support organic growth by acquiring new clients, in order to build up the necessary transaction volume to save cost by gaining the benefits of economies of scale and scope. Bilateral and multilateral clearing and settlement would be supported as well as connectivity to Eacha members, EBA Clearing and Target2. CSM functionality such as parcel, net and gross settlement would be provided



as well as back office processing functionality such as validation, pre-processing, exception handling and archiving of payment transactions. All functionalities would be available for national currency and Sepa payments (bulk and individual). Additional optional services such as Iban and BIC conversion or direct debit mandate management assure a smooth transition from national to Sepa payments.

The product portfolio of an ideal payment processor also contains issuing and acquiring processing services for international and national debit and credit card brands. Included services are – among others – EMV and Sepa Card Framework compliant card issuing and authorisation services, hosting of ATMs and POS terminals, switching and clearing and settlement. Of course, innovations such as secure and reliable electronic and mobile payments for internet or mobile

phone initiated transactions are provided. Electronic invoicing and electronic billing solutions, prepaid

All processors have their strengths and weaknesses. However, market developments show that some have at least understood which strategy they have to pursue and which obstacles they have to overcome

cards and biometric authentication and identification are delivered, too. All these services are modular, thus allowing banks to opt for one-stop shopping or pick individual services. Outstanding quality, reliability,

security and compliance of all services are acknowledged as basic offerings by such a payments processor and need not to be worried about.

In an ideal world at least a handful of those payment processors have equally high market shares so banks can freely pick one without having to fear being dependent on that processor. Obviously, not even one such payment processor exists at the moment. All processors have their strengths and weaknesses. However, market developments show that some have at least understood which strategy they have to pursue and which obstacles they have to overcome in order to narrow the gap to that ideal payment processor. **IP**

More information on the Banks and Future survey will soon be available at www.equens.com.

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